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April 13, 2006

BY HAND DELIVERY

Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

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Federal Communications Commission
Office of Secretary

Re: Ex Parte Presentation in MB Docket No 05-192

Dear Ms. Dortch:

In four *ex parte* filings over the last two months, DIRECTV, Inc. ("DIRECTV") has shown that the confidential documents produced by Time Warner Cable Inc. ("Time Warner") and Comcast Corporation ("Comcast") fully corroborate its assertions as to the anticompetitive implications of the transactions proposed in this proceeding.¹ In its most recent response,² Time Warner continues to gloss over key facts, disavow the admissions of its own senior executives, and ignore basic economic principles. The Commission should not be swayed by this latest effort at misdirection.

1. DIRECTV's Latest Accession to RSN Overcharge Pricing

Before addressing the specific factual contentions raised by Time Warner, DIRECTV feels constrained to discuss a new development. As noted by Time Warner, DIRECTV reached agreements with both SportsTime Ohio ("STO"), the regional sports network ("RSN") launched by the Cleveland Indians in cooperation with Time Warner, and SportsNet New York ("SNY"), the RSN owned by the New York Mets, Time

¹ See Letter from William M. Wiltshire to Marlene H. Dortch (Feb. 14, 2006) ("DIRECTV Feb. 14 Ex Parte"); Letter from William M. Wiltshire to Marlene H. Dortch (Mar. 15, 2006) ("DIRECTV Mar. 15 Ex Parte"); Letter from William M. Wiltshire to Marlene H. Dortch (Mar. 27, 2006) ("DIRECTV Mar. 27 Ex Parte"); Letter from William M. Wiltshire to Marlene H. Dortch (Apr. 3, 2006) ("DIRECTV Apr. 3 Ex Parte").

² See Letter from Arthur H. Harding to Marlene H. Dortch (Apr. 8, 2006) ("TWC Response").

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Warner, and Comcast. By doing so, DIRECTV ensured that its viewers will be able to watch Indians and Mets games this season.

Yet this is by no stretch of the imagination a victory for DIRECTV's viewers, and it certainly is not the validation of RSN pricing that Time Warner claims. To the contrary, it is proof that the anticompetitive strategies that DIRECTV has described throughout this proceeding are real. This will result in real price increases for DIRECTV subscribers, but not for subscribers of Time Warner and Comcast. The fact that DIRECTV felt it had no option but to accede to the demands of these two RSNs should in no way be viewed as an indication of a competitive market at work.

For months, DIRECTV has pointed out that these transactions will make RSN withholding more profitable in markets such as Cleveland and New York. It has also argued that, where a dominant cable operator would find permanent RSN withholding to be profitable, it can achieve similar anticompetitive results by engaging in alternative strategies, such as uniform overcharge pricing. If its rivals agree to pay, the cable operator extracts a supra-competitive price – a price that the cable operator itself does not *really* pay because its expenses are offset through the benefits of equity ownership or other arrangements. If rivals decline, the cable operator obtains a *de facto* exclusive (which it has already concluded to be profitable).³

This is exactly what has happened in Cleveland and New York. In both cases, the RSN set pricing at levels that can only be described as extraordinarily high – even in the expensive world of sports programming.

- STO demanded a 90% increase in the per-game rate over that previously paid by DIRECTV to FSN Ohio for Indians games. Moreover, in order to get this rate, DIRECTV had to forego the industry-standard two advertising avails per hour – which both denied DIRECTV an offsetting source of income and increased the inventory of advertising time available for Time Warner to sell under its exclusive sales agency agreement.
- Although Time Warner asserts that the price for SNY is less than the price charged by the YES Network,⁴ a closer look paints a very different picture. Because SNY carries only the Mets while YES Network carries the Yankees and Nets, the monthly rate per subscriber per professional game is % higher for **REDACTED** SNY than for YES (**REDACTED**).⁵ Given that the Yankees' post-game show

³ See DIRECTV Feb. 14 Ex Parte at 9-10.

⁴ TWC Response at 3.

⁵ As Time Warner's internal documents show,

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received higher ratings than did Mets *games* last year, there is no reason to expect SNY to command a price comparable YES Network – much less a premium above that rate.⁶

In both of these markets, Time Warner and/or Comcast actually pays a much lower effective rate, because its true cost of programming includes an offset for RSN profits (from an ownership interest) or other forms of side payments (*e.g.*, sales commissions, management fees).⁷

Because DIRECTV also enjoys a form of net effective rate with respect to Fox Sports Net RSNs, Time Warner finds DIRECTV's concerns "highly ironic."⁸ Such facile reasoning misses the point entirely. To begin with, of course, Fox Sports Net RSNs are subject to an arbitration requirement akin to that requested by DIRECTV in this proceeding. The true irony here is that Time Warner seems to have overlooked that fact.

Moreover, DIRECTV has argued that, *where cable operators possess sufficient market share to make permanent foreclosure a profitable strategy*, they can also employ a uniform overcharge pricing strategy to achieve similar anticompetitive ends. In other words, in such markets – presumably including the STO footprint, in which Time Warner will have an % share post-transaction⁹ – RSNs can set prices artificially high after securing broad distribution through their dominant cable partners, while the offsetting returns of RSN ownership interests or "side payments" give the cable operators an effective discount off the nominal RSN rates, and therefore a pricing advantage over their rivals.

By contrast, as the Commission concluded just two years ago, DIRECTV (with average market share of just 15%) cannot profitably engage in permanent foreclosure,¹⁰

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⁶ As noted by Comcast, "[t]he YES Network carries one of America's most popular professional sports teams, the New York Yankees. Indeed, the Yankees reportedly have by far the highest valuation in Major League Baseball," due in part to "the unusual strength of its team-owned RSN." See Letter from James R. Coltharp to Marlene H. Dortch at 7-8 and n.21 (Mar. 15, 2006).

⁷ See, *e.g.*, DIRECTV Mar. 15 Ex Parte at 2; DIRECTV Feb. 14 Ex Parte at 12-13.

⁸ See TWC Response at 4-5.

⁹ See *id.* at 6.

¹⁰ *General Motors Corp., Hughes Electronics Corp., and The News Corporation Ltd.*, 19 FCC Rcd. 473, 544 (2004).

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and thus cannot implement the same strategy with Fox Sports Net RSNs. So while DIRECTV – like Time Warner – can be thought of as receiving offsetting returns from affiliated RSNs, it would have no incentive or ability to arrange for a uniform overcharge price in the first place. DIRECTV thus has never argued that ownership interests and side payments are, in the abstract, unfair or anticompetitive. Rather, it argues that such arrangements can be anticompetitive when they provide the mechanism for a dominant MVPD to implement an overcharge pricing strategy.

At the end of the day, all DIRECTV subscribers face price increases so that Indians and Mets fans can continue to watch their teams. But Time Warner and Comcast subscribers do not face the same prospect. This is exactly what DIRECTV said would happen. And it is exactly what happened. Because the transactions make such anticompetitive behavior more profitable, and thus more likely, in markets throughout the country, the Commission must impose conditions to protect consumers and competition.

2. *Brief Rebuttal of Specific Assertions by Time Warner*

In this section, DIRECTV offers a brief rebuttal of certain factual assertions made in the TWC Response. As many of these assertions have been rebutted in previous DIRECTV filings, we have tried to keep the discussion to a minimum.

A. SportsNet New York (“SNY”)

Net Effective Rate. Time Warner once again asserts that the “net effective rate” provision in its SNY agreement is “nothing more than an ‘exit’ mechanism,” and argues that DIRECTV has not explained why the Mets would be willing to go along with a scheme that would not maximize RSN profits.¹¹ As DIRECTV previously noted, it is telling that Time Warner’s “exit” mechanism is only triggered by failure to achieve a specified pricing advantage over its MVPD rivals.¹² It is also interesting to note that, according to Comcast, this very provision is designed for a totally different purpose – *i.e.*, to serve

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As for the Mets, the arrangement assures broad distribution of the RSN on Time Warner and Comcast systems – no small benefit for a new, one-team RSN. In addition, Time Warner and Comcast can share their monopoly rents with the team by funding the

¹¹ TWC Response at 2-3.

¹² See DIRECTV Mar. 15 Ex Parte at 3.

¹³ See DIRECTV Apr. 3 Ex Parte at 8.

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RSN's acquisition of the underlying rights to transmit the team's games at a level that non-dominant firms cannot match.¹⁴

Transaction-Specific Effect. Time Warner argues that there is no transaction-specific effect on SNY because Time Warner will increase its share of television households in the SNY service footprint by approximately %.¹⁵ Even granting Time Warner's premise, it neglects to mention that Comcast, another applicant in this proceeding and part-owner of SNY, will increase its share in the SNY footprint by over 10%, which presumably even Time Warner would not contend is *de minimis*.¹⁶ **REDACTED**

B. SportsTime Ohio ("STO")

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Option and Sales Agreements. Time Warner argues that its option to acquire % of STO is "entirely irrelevant" because it does not convey an attributable interest until exercised and, since it must be exercised **REDACTED**, it will not allow Time Warner to capture any "long term appreciation" as DIRECTV has suggested.¹⁷ This reasoning is flawed on several counts.

First, the Applicants have repeatedly sought to limit the Commission's consideration of the transactions to markets with "affiliated" RSNs – a group, they say, not including Cleveland. Thus, the option is an ideal bridge to avoid regulatory scrutiny in the near term but lock up a substantial ownership interest soon afterward. Second, once the option is exercised, Time Warner's interest in the RSN has no termination point, allowing it to remain invested to capture any "long term appreciation" that it is able to generate by sharing its monopoly rents.

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Third, Time Warner can exercise its option and acquire a % interest in STO for a price of **REDACTED**.¹⁸ By comparison, Time Warner paid nearly five times

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¹⁵ See TWC Response at 4.

¹⁶ See *id.* at 4 n.10. Time Warner also asserts

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¹⁷ See TWC Response at 5.

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as much () to acquire a much smaller interest () in SNY. This evidence strongly suggests that Time Warner's option is already "in the money," needing only to be cashed once this proceeding has been completed. Accordingly, the option achieves both regulatory obfuscation and lower effective rates for Time Warner, and is certainly not irrelevant.¹⁹

REDACTED Rejection of Exclusivity. Because it declined the Indians' offer of exclusive carriage, Time Warner chastises DIRECTV for having "the temerity to claim that this situation 'bear[s] out DIRECTV's contention that increased clustering makes exclusive programming arrangements more likely.'"²⁰ In this same paragraph, Time Warner also notes that it will have % market share in the STO service area post-transaction. Yet it would have the Commission believe that there is no link between its dominant market share and the willingness of the Indians to offer an exclusive carriage arrangement.

To deny this link is to deny reality. After all, there is no evidence that the Indians offered such an arrangement to other, non-clustered cable operators – and it certainly did not make such an offer to DIRECTV. In fact, there is no reason to believe exclusive carriage would even have been on the table had there not been a dominant cable operator whose market share stood to increase still further in the near future. In the end, Time Warner opted for a future ownership interest in the RSN and an exclusive sales arrangement, rather than an exclusive carriage arrangement that might draw unwanted regulatory attention (as did its arrangement in Charlotte). But Time Warner cannot seriously maintain that these terms, like the original offer of exclusivity, were the result of anything other than market power all parties expected it to achieve through the proposed transactions.

Net Effective Rate. Although Time Warner's lawyers have attempted to dismiss an effective rate calculus as somehow "contrary to fundamental economics,"²¹ the views of its management are evidently quite different. **REDACTED**

¹⁹ The negotiating history surrounding the Option Agreement further corroborates the link between the proposed transactions and economic incentives. Specifically,

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²⁰ TWC Response at 6.

²¹ See, e.g., Letter from Arthur H. Harding to Marlene Dortch at 9 (Mar. 2, 2006).

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Time Warner takes a similar view of the side payments available through its advertising sales agreement. For example,

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²³ DIRECTV urges the Commission to take such a “substance over form” approach when considering the Applicants’ incentive and ability to foreclose as a result of the proposed transactions.

C. Carolinas Sports and Entertainment Network (“C-SET”)

Availability to Satellite. Time Warner criticizes DIRECTV for relying on “hearsay” rather than governing contractual provisions to argue that C-SET was not available to satellite operators.²⁴ Of course, in a court of law, a “party admission” – *i.e.*, something a party says against its own interest – is not hearsay.²⁵ And DIRECTV has documented just such admissions by Time Warner executives whose understanding and intention – notwithstanding the legal niceties of the underlying contract – was that C-SET programming would not be available to DBS operators.²⁶ Moreover, C-SET clearly

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²⁴ See TWC Response at 6-7.

²⁵ Fed. R. Evid. 801(d)(2).

²⁶ See DIRECTV Mar. 27 Ex Parte at 4; DIRECTV Mar. 15 Ex Parte at 9-10.

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shared this view.²⁷ Under the circumstances, it is disingenuous for Time Warner to now claim otherwise.

Terrestrial Delivery. As DIRECTV has documented, Time Warner originally intended to require C-SET to deliver its signal terrestrially, a strategy used by Comcast to secure exclusive carriage of its RSN in Philadelphia.²⁸ Time Warner attempts to put a benign spin on its ability to terminate carriage of C-SET if the RSN were to switch from terrestrial to satellite delivery, arguing that Time Warner could only opt out of its agreement if C-SET did not reimburse the costs imposed by such a change.²⁹ However, the provision cited by Time Warner does not appear in the draft cited by DIRECTV, which

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Time Warner also asserts that “nowhere does [DIRECTV] cite any evidence that the deleted terrestrial delivery clause ever had anything to do with exclusivity.”³¹ Not so. In addition to all the circumstantial evidence, DIRECTV cited

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³² Time Warner attempts in a footnote to disavow this

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³⁴ – indicating either personal participation in the transaction or intimate familiarity based on information from

²⁷ See DIRECTV Mar. 15 Ex Parte at 9.

²⁸ See DIRECTV Mar. 27 Ex Parte at 3; DIRECTV Mar. 15 Ex Parte at 10-11; DIRECTV Feb. 14 Ex Parte at 7.

²⁹ See TWC Response at 7.

³⁰ **REDACTED**

³¹ TWC Response at 7.

³² See DIRECTV Mar. 27 Ex Parte at 3.

³³ TWC Response at 7 n.32.

³⁴ **REDACTED**

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someone involved in the process at Time Warner. Tellingly, there is no indication

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D. Reliance on Existing RSNs to Preclude Anticompetitive Consequences

Time Warner continues to argue that the Commission need not worry about expansion of anticompetitive RSN tactics to other markets affected by the proposed transactions because existing RSNs, including those operated by Fox Sports Net, have long-term agreements with the teams.³⁵ Yet the same could have been said about the Sacramento Kings and the Chicago Bulls, Blackhawks, Cubs, and White Sox at the time the AT&T-Comcast merger was under consideration, and those teams are now carried by Comcast-affiliated RSNs. Similarly, the Mets and Indians were both carried by Fox RSNs when this proceeding began, but that is no longer the case.

As DIRECTV has recently explained, there is every reason to believe that the Applicants will continue to seek the rights to more professional teams, including those currently carried by Fox Sports Net RSNs.³⁶ Indeed,

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, yet clearly Time Warner does not view that fact as a significant impediment to its ability to acquire rights to televise the team's games in a market where it will have % market share post-transaction. This is yet further evidence that the Commission cannot rely upon existing RSN carriage agreements to prevent the Applicants from propagating their anticompetitive strategies to new markets in which the transactions will create or enhance their market power.

* * *

In its summary, Time Warner purports to contrast certain DIRECTV "predictions" with Time Warner's view of the facts.³⁸ Yet this effort misconstrues both DIRECTV's arguments and the real state of facts.

³⁵ See TWC Response at 9.

³⁶ DIRECTV Apr. 3. Ex Parte at 9-10.

³⁷ **REDACTED**

³⁸ See TWC Response at 8-9.

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- As DIRECTV has stated throughout this proceeding, while the market power created or enhanced by the proposed transactions would make outright RSN withholding (using the terrestrial loophole) a viable strategy for the Applicants, the more likely (and no less anticompetitive) strategy would be to raise rivals' costs through uniform overcharge pricing and stealth discrimination – both of which have been employed by the Applicants' new RSNs.
- As evidenced by the willingness of the Cleveland Indians to offer Time Warner – and only Time Warner – exclusive carriage of STO, the transactions will enable the Applicants to secure exclusive distribution from new RSNs in markets that they dominate.
- The Applicants will have increased incentive and ability to “lock up” sports rights in markets where the transactions will create or enhance their market power. Since Atlanta was not such a market, Turner South could not have been used effectively as a weapon against MVPD rivals. Yet clearly, the Applicants can guarantee sufficient distribution in the markets they dominate to support one-team RSNs that can be used as vehicles to acquire the rights to additional teams as they become available.

The evidence is clear, and the Commission should not be distracted by the Applicants' attempts to gloss over or disavow the import of their own internal documents.

Respectfully submitted,



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